

M. BENEFITS PROVIDED BY LABOR ORGANIZATIONS

1. Introduction

Without further elaboration, IRC 501(c)(5) provides for the exemption from federal income tax of labor, agricultural, or horticultural organizations.

While IRC 501(c)(5) does not mention any individual benefits that an organization exempt thereunder may provide to its members, for the reasons explained below a labor organization may provide various benefits to its members either directly or indirectly through a separate entity that may itself qualify for IRC 501(c)(5) exemption. One purpose of this topic is to discuss the various types of benefits an exempt IRC 501(c)(5) labor organization may provide.

As explained later, an IRC 501(c)(5) labor organization may pay many of the same types of benefits that are allowed a voluntary employees' beneficiary association exempt under IRC 501(c)(9) (VEBA). (See Appendix for a list of permissible and impermissible benefits under IRC 501(c)(9).) Another purpose of this topic is to discuss the circumstances under which an organization may qualify for exemption under IRC 501(c)(5) when it could not qualify under IRC 501(c)(9). Further, because VEBAs are subject to the nondiscrimination rules under IRC 505 and/or IRC 501(c)(9), and a more encompassing unrelated business income tax definition under IRC 512(a)(3), it is to an applicant's advantage to qualify for exemption under IRC 501(c)(5) instead of IRC 501(c)(9) in cases where it could qualify under both sections. No nondiscrimination rules as to benefits have been promulgated under IRC 501(c)(5), and the normal UBI definition applies to organizations exempt under IRC 501(c)(5).

2. Benefits - In General

Reg. 1.501(c)(5)-1 provides that organizations contemplated by IRC 501(c)(5) are those that have no net earnings inuring to the benefit of any member, and have as their objects the betterment of the conditions of those engaged in labor, agriculture, or horticulture, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

As stated in Rev. Rul. 67-7, 1967-1 C.B. 137, an exempt labor organization is one that has as its primary purpose the representation of its members in such matters as wages, hours of labor, working conditions and economic benefits. Thus,

the threshold question in determining whether an organization that is providing a particular type of benefit is exempt as a labor organization under IRC 501(c)(5) is whether the organization meets this definitional requirement. If the organization providing benefits is not a "labor organization," it will not qualify under IRC 501(c)(5) regardless of the type of benefits provided. The benefit provided may fundamentally further the purposes of a labor organization but that fact alone may not be sufficient to meet the definitional standard. Since being a labor organization is not one of the requirements for exemption under IRC 501(c)(9), this requirement is important when considering whether a VEBA or an organization providing VEBA-type benefits might qualify instead under IRC 501(c)(5).

The source of funding with respect to such an organization may be an important element in determining whether it is a labor organization. The various IRC 501(c)(5) authorities discussed below state how the particular benefits are funded. Although there is no general rule on funding under IRC 501(c)(5), labor organizations have normally and traditionally been funded directly or indirectly by the membership. As Rev. Rul. 62-17, 1962-1 C.B. 87, puts it ". . . the legislative history of the provisions exempting labor organizations from income taxation indicates that labor organizations were exempted for the very reason that they operated, in part, as mutual benefit organizations. . . ." The exempt organization described therein was funded by the members, which is normally the essence of mutuality. Contrast this with the method of funding VEBAs. Although, with respect to most benefits, VEBAs may be funded by employee-members, employers, or both, the vast majority are in fact funded by employers. Because many employer-funded VEBAs would have difficulty showing that they are labor organizations, it is doubtful that they could qualify under IRC 501(c)(5) even though they might be paying benefits permitted by that section. On the other hand, employee-funded organizations providing the VEBA-type benefits discussed below might be able to qualify under either IRC 501(c)(9) or (c)(5).

3. Specific Benefits

For purposes of discussion, specific benefits are broken down between benefits that, in general, would not be permitted under IRC 501(c)(9), regardless of the circumstances, and those that could conceivably qualify under that section.

A. Benefits Permissible Under IRC 501(c)(5) But Not Under IRC 501(c)(9)

In general, the benefits in this part would not qualify under IRC 501(c)(9) whether funded by employees, employers, or both.

G.C.M. 35862 (June 20, 1974) in concluding that the conduct of an employee-funded pension plan is a permissible function of the exempt labor organization described therein, provides a good overview of the legislative history of IRC 501(c)(5) labor organizations. It states that while the legislative history of the Revenue Act of 1909, the original law providing for the exemption of labor organizations, does not refer to pension plans or specifically indicate whether Congress had such plans in mind in exempting labor organizations, at the time of enactment of the statute some unions had employee-funded pension plans and were paying pension benefits. In view of the legislative history of IRC 501(c)(5) and the historical practices and practical significance of pension programs, it is clear that an employee-funded pension plan is germane to the purpose of a labor organization, even though a pension plan, unlike death, sick, accident and similar benefits, is not an intermittent, contingent benefit based on the interruption of the member's earning power, but is, in part, an investment program enabling participants to set aside their own funds to be invested for retirement. Pension benefits are not proper benefits of an IRC 501(c)(9) organization because they are deferred compensation, which is an impermissible benefit. Reg. 1.501(c)(9)-3(f). If the pensions are employer-funded they would not be a permissible benefit under IRC 501(c)(5) as well. In order for an employer-funded pension plan to qualify for exemption, it must meet the tests of IRC 401.

While an IRC 501(c)(9) organization can provide severance benefits if they are no more than twice annual compensation and are payable within the two years of termination of service, the benefits are not permissible if they may be payable at retirement. In such a case, the severance benefits are in actuality a form of deferred compensation similar to a pension. However, a labor organization, unlike a VEBA, is not precluded from paying a benefit that ambiguously straddles the line between a pension and a severance benefit. For example, G.C.M. 35790 (April 23, 1974) states that although there is no direct precedent for allowing a labor organization to provide a lump sum retirement or similar benefit for workers who "resign from work," the payment of such funds is proper in the case under consideration because of the following unique facts:

- (1) The benefits were interrelated with the training benefits being provided to the union's younger members, and senior members could not take advantage of the training benefits although they contributed more financially to the union. For this reason the union was providing equivalent benefits to eligible

unemployed members or eligible members who retire or resign from work.

- (2) The benefits would be paid as a single, lump-sum payment from a previously existing unemployment fund; and
- (3) the fund from which the benefits were to be paid was accumulated exclusively from union dues or from other contributions from the union members, and not from outside sources.

The benefits do not constitute a form of private inurement because the noninurement test under IRC 501(c)(5) does not proscribe all expenditures of union funds that result in monetary benefit to individual members, but only those benefits not recognized as being a proper activity of a labor organization.

Rev. Rul. 75-473, 1975-2 C.B. 213, describes a labor organization established pursuant to a collective bargaining agreement between a labor union and an association of employers. The organization's primary purpose is to allocate work assignments among eligible union members by operating a dispatch hall. The dispatch hall is operated by union members, but it is under the supervision of a joint committee composed of an equal number of employer and union representatives. Its funding is likewise supplied on an equal basis by the parent labor union and the parent employer association. In addition to maintaining and operating the dispatch hall, the organization decides questions regarding rotation of work crews and extra men, and investigates and adjudicates grievances and disputes that arise in connection with the working conditions, the job performance of union members, and the operations of the dispatch hall.

In holding that the organization qualifies for exemption, the revenue ruling states that an organization that is engaged in activities appropriate to a labor union, even though technically not a labor union itself, may qualify for IRC 501(c)(5) exemption if its activities are appropriate union activities and are conducted as a part of the proper activities of the parent labor organization, so that it is not merely an independent undertaking. According to the revenue ruling, the operation of a dispatch hall better the conditions of those engaged in labor pursuits by providing them with a continuity of work assignments and orderly transfers from one work assignment to the next. The revenue ruling also states that providing facilities to investigate and adjudicate grievances also helps promote improved working conditions and more harmonious union and employer relations.

In contrast to the above revenue ruling, Rev. Rul. 77-46, 1977-1 C.B. 147, holds that a nonprofit organization established under a collective bargaining agreement between a union and an employers' association to enable members of the union to save money does not qualify for IRC 501(c)(5) exemption. The revenue ruling states that providing a savings plan is not a benefit for which labor organizations have traditionally been exempted from federal income taxation.

B. Benefits Permissible Under Both IRC 501(c)(5) and IRC 501(c)(9)

The benefits described in this part are of the types that are permissible under both IRC 501(c)(5) and IRC 501(c)(9).

Rev. Rul. 62-17, 1962-1 C.B. 87, holds that exempt labor organizations may provide for employee-funded sick, death, accident, and other benefits for members because "the legislative history of the provisions exempting labor organizations from income taxation indicates that labor organizations were exempted for the very reason that they operated, in fact, as mutual benefit organizations providing death, sick, accident, and similar benefits to their members." These are essentially the same benefits that an IRC 501(c)(9) organization can provide. See Appendix for a list of permissible benefits that may be provided by an IRC 501(c)(9) organization.

One type of benefit provided directly to individual members that is deemed to fundamentally further a labor organization's exempt purpose was addressed in G.C.M. 34634 (October 8, 1971). That G.C.M. concludes that employee-funded vacation benefits are benefits that may be paid by an exempt labor organization and that the separate organization established by an exempt labor organization to provide such benefits for its members could itself qualify for IRC 501(c)(5) exemption. It states that providing such benefits is an integral part of the overall health and welfare program of the exempt parent and that an activity carried on by such a subsidiary organization need not be the kind of activity that would allow a subsidiary organization to qualify independently for exemption but need only be the kind of activity necessary to the carrying out of the parent's exempt purposes. The same benefit would also be permissible for a VEBA under Reg. 1.501(c)(9)-3(e).

Under Reg. 1.501(c)(9)-3(e), a VEBA may provide employees with prepaid personal legal services only in two cases. Such benefits may be provided if paid to an IRC 501(c)(20) organization or trust as part of a qualified group services plan under IRC 120 or, alternatively, if provided by a collectively-bargained plan.

G.C.M. 38981 (January 26, 1983), citing Rev. Rul. 75-288, 1975-2 C.B. 212, and Rev. Rul. 74-596, 1974-2 C.B. 167, concludes that an organization providing prepaid legal services to members of a local tax exempt labor organization may qualify for IRC 501(c)(5) exemption. The organization was a group legal services plan established by the local and created by a vote of the membership. The organization was funded solely through membership dues, was not supported by employers, and was not connected with a qualified group services plan described in IRC 120, and, therefore, did not qualify for IRC 501(c)(9) exemption.

Reg. 1.501(c)(9)-3(e) clearly allows a VEBA to provide employees with payments in the event of economic dislocation. G.C.M. 37424 (February 22, 1978) concludes that the operation of a hardship fund to pay benefits to members of an exempt labor organization who encounter financial or economic hardship is an appropriate labor organization activity within the scope of IRC 501(c)(5). According to the G.C.M., such a payment is made to a member who, because of financial emergency, is unable to support himself and his family and the provision of such benefits cannot properly be distinguished from the provision of death, sick, and accident benefits to members of a labor organization. Unlike the payments in Rev. Rul. 62-17 for death, sick, accident and similar benefits, the hardship fund was not financed solely by members' dues but was also funded from royalty and interest income. The G.C.M. concludes that funding may be provided from outside sources (investment income) because the advancement of the economic self-interest of its members is basic to the purposes and activities of a labor organization and the noninurement test does not proscribe the general use of funds by a labor organization to advance the economic self-interest of its members in traditionally recognized manners. The G.C.M. states that making the unrelated business income tax applicable to labor organizations strongly suggests that Congress approved of labor organizations earning significant amounts of unrelated income without endangering their exempt status. It states further that allowing income from outside sources in the context of a labor organization implies that union members are permitted to obtain pecuniary benefits from their membership beyond their individual contributions.

Reg. 1.501(c)(9)-3(e) provides that education or training benefits or courses (such as apprentice training programs) for members are permissible VEBA benefits. Such benefits are acceptable under IRC 501(c)(5) as well. G.C.M. 35790 (April 23, 1974) concludes that retraining and educational benefits are permissible labor organization activities because they enable union members to obtain new skills to change occupations because of technological innovation. Such educational benefits contribute to the betterment of the working conditions of union members

within the meaning of Reg. 1.501(c)(5)-1(a). It also concludes that the payment of unemployment benefits for laid-off workers is a common and proper activity of a labor organization.

Rev. Rul. 67-7, 1967-1 C.B. 137, holds that an organization established by a labor union to provide strike and lockout benefits to its members qualifies for IRC 501(c)(5) exemption. The organization is funded by members. The revenue ruling states that strike benefits are directed to furthering a labor union's primary purpose of representing its members in matters of wages, hours of labor, working conditions, and economic benefits. Thus, certain types of benefits, such as strike benefits that are provided directly to individual members, are deemed to further fundamentally a labor organization's exempt purpose. However, see Rev. Rul. 76-420, 1976-2 C.B. 153, which holds that an organization providing weekly income to its members in the event of a strike by the members' labor unions does not qualify for IRC 501(c)(5) exemption. The organization was controlled by private individuals and not by an exempt labor organization, and it had no authority to represent or speak for its members in matters relating to their employment, such as wages, etc. Although we have not seen any VEBAs offering strike and lockout benefits, it would appear to be a contingency that interrupts earning power within the meaning of Reg. 1.501(c)(9)-3(d)(2).

C. Employer-Funding

As the above discussion indicates, many VEBA-type benefits provided by a labor organization for its members are deemed to be in furtherance of an exempt IRC 501(c)(5) purpose when the benefits are employee-funded, that is, from such sources as membership dues, fees, and assessments. However, there is little published precedent regarding the extent to which employer funds can be used to finance employee benefits provided by an organization that would otherwise qualify for IRC 501(c)(5) exemption, especially if the organization would qualify for IRC 501(c)(9) exemption. It is apparent that some benefits may be financed in part by employers. Rev. Rul. 78-42, 1978-1 C.B. 158, holds that a nonprofit apprenticeship and training committee, a trust formed by a union and an employers' association of a particular industry in connection with a collective bargaining agreement, qualifies for IRC 501(c)(5) exemption. The committee conducted educational courses in various aspects of the trade for members. While the revenue ruling does not state how the program was funded, apparently both the union and the association financed the program.

There is also a lack of precedent with respect to employer-funding for non-VEBA type benefits, but it is clear from Rev. Rul. 75-474 that the operation of a dispatch hall may be financed by employers and the union. See also Rev. Rul. 77-5, 1977-1 C.B. 145, which holds that a trust formed pursuant to a collective bargaining agreement, funded and administered by employers in an industry to compensate a multi-employer steward under the union's direct control to settle disputes, investigate complaints, etc., qualifies for exemption as a labor organization. Because of the lack of published precedent with respect to employer-funded benefits, IRM 7664.1 is applicable, and cases not described in the above revenue rulings should be referred to the National Office.

4. Other Considerations

A. Separate Entity

While an exempt IRC 501(c)(5) labor organization may provide the permissible benefits described above directly to its members, it may also choose to establish a separate entity to provide such benefits and the separate entity may qualify for IRC 501(c)(5) exemption. As previously indicated, the provision of vacation benefits by a subsidiary of an exempt labor organization to the members of the union is an integral part of the overall health and welfare program of the exempt parent. An activity carried on by such a subsidiary organization need not be the kind of activity that would allow a subsidiary organization to qualify independently for exemption (if the activity were not conducted for the parent) but need only be the kind of activity necessary to the carrying out of the parent's exempt purposes (i.e., an "integral part" of the parent's exempt activities). In Portland Cooperative Labor Temple Association, 39 B.T.A. 450 (1939), acq. 1939-1 (Part I) C.B. 28, the Board of Tax Appeals held that an organization that was owned and controlled by labor unions to operate a "labor temple" for the unions qualified for IRC 501(c)(5) exemption because the organization's activities were appropriate union activities and were conducted as a part of the parent labor organization's own activities. The Board held that the term "labor organization" must be broadly construed, and that what one labor organization could do for itself several should be allowed to do collectively through a corporate entity they create. (This rationale should be applied with caution, however, particularly outside the IRC 501(c)(5) area. See, for example, the line of cases dealing with hospital laundries under IRC 501(c)(3).)

In addition, with respect to welfare benefits, section 403 of the Employee Retirement Income Security Act of 1974 (ERISA) requires that a separate trust be

established to administer employee welfare benefit plans defined by section 3(1) of the Act. Therefore, labor organizations wishing to comply with ERISA will establish separate trusts through which member welfare benefits will be paid to members.

B. Investment Income

As previously indicated, the funding for hardship benefits to members can be provided from outside sources, such as royalty and interest income. As explained above, most labor organization benefits are funded by members and, therefore, normally financing such benefits from investment income is proper if it is derived from members' dues and assessments.

C. Agricultural Organizations

It must be emphasized, however, that while the legislative history indicates that labor organizations have historically operated in fact as mutual benefit organizations, this is not the case with exempt IRC 501(c)(5) agricultural organizations. The Service has consistently taken the position that "bettering the conditions of those engaged in such pursuits," means bettering the conditions of agriculture in general rather than benefiting the individual members specifically. Thus, the provision of individual benefits by an IRC 501(c)(5) agricultural organization to its members violates the prohibition against inurement. Therefore, the holding of Rev. Rul. 67-251, 1967-2 C.B. 196, i.e., that the provision of welfare aid and financial assistance to the members of an IRC 501(a)(6) organization constitutes prohibited inurement, would also apply to IRC 501(c)(5) agricultural and horticultural organizations.

APPENDIX

Reg. 1.501(c)(9)-3 describes in considerable detail the kinds of permissible benefits that an IRC 501(c)(9) organization may provide to its members. According to this regulation, "other benefits" include only those benefits that are similar to life, sick, or accident benefits. It states that a benefit is similar to these benefits if (1) it is intended to safeguard or improve the health of a member or a member's dependents, or (2) it protects against a contingency that interrupts or impairs a member's earning power.

There have been few developments in the last several years concerning what benefits may be provided by an organization described in IRC 501(c)(9). Generally, the discussions in the 1983, 1984, and 1986 CPE Topics are still applicable.

The following chart provides a summary of benefits that are permissible under Reg. 1.501(c)(9)-3:

PERMISSIBLE BENEFITS (ALL VEBAs)

- Term Life Insurance
- Group Whole Life Insurance (as defined in IRC 79)
- Accidental Death and Dismemberment (AD&D)
- Medical
- Dental
- Disability (both long and short-term)
- Vacation Pay
- Vacation Facilities
- Recreational Expenses
- Child-care
- Job Readjustment Allowances
- Income Maintenance Payments in Times of Economic Dislocation
- Temporary Living Expense Loans and Grants in Times of Disaster
- Supplemental Unemployment Compensation (SUB) Benefits
- Severance Pay (if provided in accordance with 29 CFR Section 2510.3-2(b))
- Education or Training Benefits or Courses for Members
- Personal Legal Service Payments (through IRC 501(c)(20) organizations only)

Any other benefit meeting the criteria of Reg. 1.501(c)(9)-3(b), (c), (d), or (e)

ADDITIONAL PERMISSIBLE BENEFITS FOR COLLECTIVELY BARGAINED VEBAs ONLY

Benefits provided, in the manner permitted by paragraphs (5) et. seq. of section 302(c) of the Labor Management Relations Act. The only significant types of benefits referred to, for practical purposes, are

- 1) Educational or Training Benefits for Dependents of Members
- 2) Personal Legal Service Benefits (other than through an IRC 501(c)(20))

IMPERMISSIBLE BENEFITS

Whole Life Insurance (nonqualifying under IRC 79)
Accident Insurance on Property
Homeowners' Insurance
Commuting Expenses
Malpractice Insurance
Loans (other than in times of distress)
Savings Facilities
Pensions
Annuities, payable at retirement
Stock Bonus or Profit-sharing Plans
Any other Deferred compensation benefits
Dependents' Education (noncollectively bargained plans)